Agenda Date: 1/9/02
Agenda Item: 2D

STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102

IN THE MATTER OF THE PETITION OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY'S PROPOSAL TO TRANSFER ITS RIGHTS AND OBLIGATIONS UNDER ITS GAS SUPPLY AND CAPACITY CONTRACTS AND OPERATING AGREEMENTS TO AN UNREGULATED AFFILIATE AND OTHER RELIEF)	ENERGY ORDER APPROVING TRANSFER OF CONTRACTS BPU DOCKET NO. GM00080564 OAL DOCKET NO. PUCOT-09734-00N

(SERVICE LIST ATTACHED)

BY THE BOARD:

PROCEDURAL HISTORY

On August 11, 2000, Public Service Electric and Gas Company ("PSE&G" or "Company") filed a petition with the Board of Public Utilities ("Board" or "BPU"), for approval to transfer its rights and obligations under its capacity contracts and operating agreements, to an unregulated affiliate ("Newco" or "Affiliate"). PSE&G proposed that it would enter into a Requirements Contract under which Newco would provide the interstate capacity, storage and gas supply needed for PSE&G to satisfy its obligation to provide Basic Gas Supply Service ("BGSS"). PSE&G also proposed to implement an optional Capacity Release Program that would ensure that Third-Party Suppliers ("TPS") would have an opportunity to obtain interstate capacity to deliver natural gas to their customers on PSE&G's system if they were unable to obtain such capacity elsewhere.

As part of its petition, PSE&G proposed to eliminate the Company's annualized commodity pricing component under its Commodity Service ("CS") rate schedules, the successor to the Levelized Gas Adjustment Clause ("LGAC"), including the elimination of the use of deferred accounting and true-up provisions. PSE&G proposed to move its firm gas customers, currently served under that levelized mechanism, to monthly, market based pricing under the Company's Market Price Gas Service ("MPGS") rate schedule.

The matter was transferred to the Office of Administrative Law ("OAL") on October 26, 2000, for hearing as a contested case and assigned to Administrative Law Judge ("ALJ") Louis G. McAfoos, III. Parties to the case included PSE&G, the Division of Ratepayer Advocate ("Advocate") and Board Staff ("Staff"). On December 19, 2000, a pre-hearing conference was conducted at the OAL, at which time a discovery and litigation schedule was established. At the December 19, 2000 pre-hearing conference, the ALJ granted intervenor status in this matter to

North Jersey Energy Associates ("NJEA"), Mid-Atlantic Power Supply Association ("MAPSA"), Independent Energy Producers of New Jersey ("IEPNJ"), the New Power Company ("New Power"), Shell Energy Services Co. ("Shell"), the Enron Corporation ("Enron") and New Jersey Business Users ("NJBUS"), (collectively "the Parties"). In a letter from PSE&G to the ALJ, dated December 21, 2000, the ALJ's oral rulings on the various interventions were summarized.

Public hearings were held in Mt. Holly, NJ, on January 29, 2001, in New Brunswick, NJ, on January 30, 2001, and in Hackensack, NJ, on February 1, 2001. Evidentiary hearings were held at the OAL on March 26, April 16, May 21, May 22, June 13, June 15, and June 22, 2001. On March 9, 2001, PSE&G amended its filing to defer transferring residential gas customers to its MPGS service for two years. The Company presented four witnesses, the Advocate presented two witnesses and Shell presented one witness in the proceeding.

On March 20, 2001, the Advocate filed a motion to dismiss PSE&G's petition, arguing that it was contrary to the policies and mandates of the Electric Discount and Energy Competition Act ("EDECA"), N.J.S.A. 48:3-49 et seq. The ALJ did not rule on the Advocate's motion. On March 22, 2001, NJBUS submitted a letter in support of the Advocate's motion to dismiss. On March 26, 2001, PSE&G filed its response to the Advocate's motion to dismiss. PSE&G also submitted a letter in opposition to NJBUS' March 22, 2001 letter in support of the Advocate's motion to dismiss. On March 29, 2001, Shell submitted a letter in opposition to the Advocate's motion. On April 2, 2001, the Advocate submitted its reply to PSE&G's and Shell's letters.

STIPULATION OF SETTLEMENT AND FIRST ADDENDUM

On April 16, 2001, a Stipulation of Settlement ("Stipulation") was executed by PSE&G, Shell, Enron and New Power, and unopposed by MAPSA, and was entered into the record. Staff and the Advocate did not sign the Stipulation of Settlement.

The Stipulation provides as follows:

1. PSE&G's rights and obligations under its Gas Transportation and Storage contracts shall be transferred to an unregulated affiliate, and valued at the current contracts costs.

2. Adjustments to the shopping incentives contained therein shall become effective on the later of 60 days after receipt of the Board's written Order approving the Stipulation or the effective date of implementation of the collection of the Gas Cost Underrecovery adjustment, pursuant to the Board's Order in Docket No. GR00070491 (LGAC proceeding).

3. An Initial FT Capacity Release Program shall be made available to Third Party Suppliers. The program shall be implemented on the effective date of the contract transfer to Newco.

4. A Citygate Storage and Redelivery Program shall be made available to TPS licensed by the Board who supply gas to customers who switch to TPS service after the effective date of the contract transfer to Newco. The program shall be implemented on the effective date of the contract transfer to Newco.

5. A Permanent Capacity Release/ Assignment Program shall be made available to TPS licensed by the Board who supply gas to customers who switch to TPS service after the effective date of the contract transfer to Newco. This program shall be implemented on the effective date of the contract transfer to Newco.

6. PSE&G and Newco shall adhere to all legal requirements regarding affiliate standards, including those approved by the Federal Energy Regulatory Commission ("FERC") and the Board.

7. Upon the effective date of the contract transfer to Newco, the Basic Gas Supply Service ("BGSS") rates for residential customers taking their delivery on rate schedule Residential Service Firm Transportation-Gas Service ("FT-RSG") will continue to be priced by PSE&G in accordance with rate schedule Commodity Service Residential Service ("CS-RSG"). The current LGAC mechanism to establish the rates for the commodity charge shall continue to include utilization of deferred accounting and monthly filings with the Board and be governed by the Board's Order in Docket No. GR00070491. Margins generated from off-system sales shall be credited to residential BGSS customers pursuant to the Board-approved sharing mechanism in effect at that time.

8. Residential customers shall be priced at market price, under the rate schedule MPGS, effective April 1, 2004. Effective April 1, 2004, Newco shall be at risk for all contract costs. The commodity charge rate mechanism shall terminate effective April 1, 2004.

   If an over/underreccovery exists at the time of implementation of MPGS to residential customers, that amount shall be collected from or credited to all FT-RSG customers over a period not to exceed two years, together with interest at the rate for the Societal Benefits Clause ("SBC") over or underrecoveries.

9. The Requirements Contract shall contain the following provisions:

   a. Newco shall provide the full requirements needed by PSE&G to render service pursuant to PSE&G's BGSS rate schedules.

   b. The initial term of the Requirements Contract ends on March 31, 2004. In the event PSE&G terminates the contract at the end of the initial term, Newco will have the option to return to PSE&G no more than 50% of each capacity and commodity contract then in effect. PSE&G may, at its option, extend the term of the Requirements Contract for three additional years. The Requirements Contract shall not be extended beyond the time that PSE&G no longer has the obligation to provide BGSS.

c. Consideration paid by PSE&G for the Requirements Contract shall include all amounts billed by PSE&G pursuant to: 1) the BGSS firm sales rates schedules, including CS-RSG and MPGS; 2) gas supply and capacity charges and/or margins under the BGSS interruptible sales rate schedules and transportation agreements (excluding Non-Firm Transportation Gas Service margins); 3) balancing charges pursuant to the FT rate schedules; 4) the Generation Affiliate Supply Arrangement [1]; and 5) non-tariff service agreements.

d. Newco shall provide monthly information regarding the rates to be charged by PSE&G for providing MPGS.

e. Newco shall provide a performance warranty whereby Newco agrees to maintain sufficient transportation and storage entitlements and sufficient natural gas supplies to enable it, in conjunction with PSE&G's Peak Shaving Facilities, to have available each day for delivery PSE&G's total requirements for natural gas.

10. The Company shall increase its Non-Gulf Coast Rate applicable to MPGS service by 2.1 cents per therm, excluding sales and use tax ("SUT"), to recover higher fixed costs under pipeline capacity contracts and an adjustment to the number of degree-days in a normal year. PSE&G's commodity cost shall be increased by 8 cents per dekatherm (excluding SUT) to reflect the higher costs of gas in inventory.

11. If one year from the effective date of a Board Order in this proceeding, the switching rate for customers switching to TPS for retail service does not achieve the 20% switching, PSE&G shall implement a 1.8 cents per therm shopping incentive for each customer class that does not achieve the 20% threshold. The following rate schedules are included: Large Volume Firm Transportation Gas Service ("FT-LV"), General Service Firm Transportation Gas Service ("FT-GS"), Street Lighting Service Firm Transportation Gas Service ("FT-SLG"), Firm Transportation Gas Service ("FT-UVNG"), Cogeneration Service Firm Transportation Service Gas ("FT-CFG") and FT-RSG.

[1] As defined in the Requirements Contract, the term "Generation Supply Arrangement" means the supply arrangement approved by the Board in Docket Nos. EO97070461, EO97070462, and EO97070463, whereby PSE&G was authorized to supply, on an as needed basis, dedicated intrastate natural gas transportation service for PSE&G's generation affiliate with respect to certain transferred generation facilities in accordance with the Stipulation approved by the Board in Docket No. ER94070293, OAL Docket No. PUC 7328-94, on May 5, 1995, or any successor to such arrangement.

12. Current Board approved gas cogeneration contracts shall remain unaffected by the Board's approval of the Stipulation.

13. The balancing charge for firm transportation customers shall remain at $0.075736 per therm ($0.080280 per therm including SUT) of balancing use pursuant to rate schedules FT-GS, FT-LV, FT-SLG, FT-UVNG, FT-CFG and FT-RSG. The current methodology for determining the rate shall remain in place.

14. The parties shall begin a collaborative process to develop a retail BGSS Pilot Program, upon the effective date of a Board Order approving the Stipulation.

Discovery concerning the Stipulation was conducted between April 16 and the resumption of hearings on May 21, 2001.

At the hearings, an Addendum to the Stipulation of Settlement ("First Addendum"), executed by PSE&G, Shell, NJEA, and IEPNJ, was entered into the record. The First Addendum adds NJEA and IEPNJ to the Stipulation and includes a revised paragraph 12 from that in the initial Stipulation. The First Addendum provides that the gas contracts transfer results in no impact to the cogeneration supply and pricing contracts. The First Addendum also provides that after fulfilling its BGSS obligation to PSE&G, and its capacity obligations to TPS, Newco shall make available surplus capacity to generation facilities, within PSE&G's service territory, that are not owned by PSE&G or its affiliates. Amendments to the proposed Requirements Contract were provided to all parties on May 14 and May 30, 2001.

INITIAL BRIEFS

On August 15, 2001, PSE&G, Staff, the Advocate and MAPSA filed Initial Briefs. Shell filed its Initial Brief on August 16, 2001. The positions of the parties were as follows:

Company Position

The Company asserts that the settlement proposals are in the public interest and should be adopted as reasonable. The Company states that the Settlement will substantially advance competition in its market area and that the Advocate's arguments are without merit and should be rejected. The Company requests that the Board enter an Order adopting the Stipulation as reasonable.

Advocate Position

In its Initial Brief, the Advocate recommends that the Board should reject both the proposed contract transfer and Requirements Contract with Newco. First, the Advocate asserts that the Company's proposal to transfer its interstate transportation and storage contracts and other gas supply resources to an unregulated affiliated is: 1) contrary to the policies of EDECA; 2) in violation of EDECA's mandates requiring full BPU regulation of BGSS; and 3) imprudent as a matter of gas supply procurement policy. Second, the Advocate asserts that PSE&G should be directed to implement measures to encourage competition while it retains control of its essential natural gas supply resources. Third, the Advocate asserts that, in accordance with the legislative directives of EDECA, the transfer should be considered only after a robust competitive natural marketplace has developed and the Board is assured that PSE&G's control of its gas supply resources is no longer needed to assure reliable and reasonably priced BGSS. The Advocate further asserts that, in order to prevent undue preference to PSE&G's affiliates, and to assure that ratepayers receive the full value of any transferred resources, any transfer should be subject to competitive bidding.

For these reasons, the Advocate argues that if PSE&G's proposed transfer is adopted, it would create inordinate risks for New Jersey's energy markets and energy consumers, while providing PSE&G affiliates with the opportunity to gain windfall profits at ratepayer expense.

Staff Position

In its Initial Brief, Staff recommends that: 1) the Board should reject PSE&G's proposal to impose binding arbitration upon the Board as it would undermine the Board's statutory authority; 2) the Requirements Contract should require that Newco be held responsible for Board approved reliability standards for its firm customers; 3) the Board should provide safeguards to ensure that the proposed BGSS pilot program requires Newco to meet PSE&G's BGSS obligations, until the Board provides further guidance through its generic BGSS proceeding; 4) in the event FERC's capacity release regulations change while PSE&G retains BGSS responsibility, the Board should permit a further review of the valuation of the contracts transferred; 5) a weather normalization adjustment using a thirty-year average should continue to be utilized; and 6) Newco, as well as PSE&G affiliates, should be bound by the Board's Affiliation Relations Standards, to ensure that there is no preferential treatment with regard to capacity and storage release between PSE&G and Newco. Staff concludes that the transfer should not be approved until these concerns are met.

Shell Energy Position

In its Initial Brief, Shell asserts that the Stipulation provides a structure for a comprehensive program that will enable PSE&G to effectuate the contract transfer, and at the same time establish a relationship between the parties that is intended and designed to result in a vibrant, competitive marketplace for natural gas in the PSE&G service territory. Shell also asserts that for the first time, PSE&G has agreed to provide transportation and storage assets required by TPS to provide reliable, cost effective service, and has also offered significant economic incentives designed to induce low-use customers to switch to alternative providers. Last, Shell asserts that the Stipulation is a significant step towards achieving EDECA's public policy goal and should facilitate the transition from traditional monopoly structure to a competitive marketplace. Accordingly, Shell recommends adoption of the Stipulation.

REPLY BRIEFS

On September 14, 2001, PSE&G and Staff filed Reply Briefs. On September 17, 2001, the Advocate filed its Reply Brief. The positions of the parties were as follows:

Company Position

PSE&G agrees to modify its proposals in the Stipulation to satisfy all of Staff's concerns as expressed in Staff's Initial Brief. PSE&G also argues that the Advocate's arguments should be rejected as without merit, especially in view of Company's willingness to modify its Stipulation to accept Staff's position, as set forth in its Initial Brief.

Advocate Position

The Advocate asserts that: 1) the Stipulation fails to address the fundamental issue of market power; 2) the Stipulation is in violation of EDECA'S mandate for continued Board oversight of BGSS, specifically as it relates to reliability and BGSS pricing; 3) the Stipulation would appropriate ratepayer-funded assets without proper compensation; and 4) Staff's proposed remedial measures are inadequate to remedy serious flaws in the Stipulation with respect to the issues of continued Board oversight of BGSS, reasonably priced BGSS, continued Board ratemaking authority, valuation and undue preference.

The Advocate recommends that the Stipulation should be rejected as inconsistent with the policies and mandates of EDECA, and that the Board adopt the recommendations set forth in its Initial Brief.

Staff Position

Staff relies upon the position presented in its Initial Brief.

FURTHER PROCEDURAL DEVELOPMENTS

On October 1, 2001, the parties were advised that the ALJ would be departing State service prior to completion of the case. Due to his imminent departure, the ALJ convened a conference call with the parties on October 3. Rather than transfer the case to a new ALJ, the ALJ recommended to the parties that the Board should, in accordance with the provisions of N.J.A.C. 1:1-3.3(a), recall this matter. All parties concurred with the recommendation. During the conference call, the ALJ established a schedule for closing the record. That schedule was as follows: signatories to the Stipulation of Settlement and Addendum thereto had until October 17 to file a Second Addendum thereto, with the Parties' responses due by October 31, 2001, which was after the date of the ALJ's departure.

At its agenda meeting of October 12, 2001, the Board determined to recall the Gas Contract Transfer case from the OAL. On October 15, 2001, the Board's Secretary sent a letter to the OAL requesting that this case be returned the Board on November 1, 2001, after the close of the record.

SECOND ADDENDUM TO THE STIPULATION

On October 26, 2001, PSE&G filed a Second Addendum ("Second Addendum") to the Stipulation. In addition to PSE&G, signatories to the Second Addendum included Shell, NJEA, New Power, Enron and IEPNJ. Staff and the Advocate did not sign the Second Addendum. The Second Addendum addresses five concerns as presented by Board Staff in its Initial Brief. The Second Addendum provides that the signatories agree to the Stipulation and First Addendum with modifications, including the following:

1. Paragraph 11.2 of the Requirements Contracts, entitled Regulatory Risk, is deleted. Additionally, Article 18, including paragraph 18.1, of the Requirements Contract is also deleted, with a substitution providing that except to the extent that jurisdiction is conferred upon FERC under the Natural Gas Act or other applicable federal law, jurisdiction to resolve disputes arising under the Requirements Contract shall reside exclusively in the Superior Court of New Jersey and be governed by the laws of New Jersey.

2. The Requirements Contract will be modified to reflect that Newco is obligated to abide by any Board approved reliability standards applicable to PSE&G's gas operations with respect to wholesale gas supplies, including capacity, for the period in which PSE&G is obligated to provide BGSS. Newco shall be entitled to participate as a party in any proceeding before the Board pertaining to the establishment of reliability standards.

3. Consistent with Staff's recommendations in its Initial Brief, the parties agree that:

    a. A weather normalization adjustment using a thirty-year average will be utilized;

    b. Newco is obligated to provide service to PSE&G to fulfill its BGSS service. The Requirements Contract shall be modified to reflect such continuing obligations, and

    c. PSE&G shall provide written notice to all industrial and commercial customers, currently served under rate schedules CS-V and CS-GS, of the change in service to MPGS within thirty days of the Board's Order approving the transfer.

4. To maintain the Non-Gulf Coast Cost component at $1.26/Dth, PSE&G shall remove from the Non-Gulf Coast Cost component contributions for off-system sales margins for industrial and commercial customers only. Margin sharing for residential customers shall not be affected. Residential gas customers shall continue to receive margins from off-system sales pursuant to the applicable Board Order addressing those margins.

5. In the event FERC removes the rate ceiling applicable to valuation of the contracts, within five years of any action by the Board authorizing the proposed transfer, the Board maintains the right to review the valuation of the transferred contracts.

6. PSE&G agrees that the Requirements Contract shall be modified to reflect that Newco agrees not to provide any undue preferences to retail gas supplier affiliates with respect to the sale of commodity, release or assignment of interstate pipeline transportation and storage capacity.

7. Paragraph 8 of the Stipulation is modified so as to provide that residential customers shall not be priced under rate schedule MPGS prior to April 1, 2004. At least one year prior to April 1, 2004, PSE&G shall file for Board approval to implement rate schedule MPGS pricing for residential customers.

8. A revised Requirements Contract, including the changes described above, shall be submitted to the Board for approval.

SUPPLEMENTAL BRIEFS

On October 31, 2001, the Advocate filed its Supplemental Brief in response to the Second Addendum. The Advocate's Supplemental Brief reiterates issues, which were raised in varying degrees by the Advocate in its earlier filings. First, the Advocate claims that approval of the PSE&G proposal would result in the Board losing regulatory oversight of BGSS. The Advocate indicates that the modifications included in the Second Addendum do nothing to assure the

Board's continuing authority over matters affecting the reliability and pricing of BGSS. Advocate Supplemental Brief at 3. The Advocate continues that the Second Addendum fails to address its concerns because it places reliability obligations on Newco, does not specify long term pricing terms and is effectuated through contractual obligations that are outside the Board's jurisdiction. The Advocate concludes that even with the Addenda, the PSE&G proposal would cause the Board to lose its ability to oversee gas procurement and its ability to assure reliable and reasonably priced BGSS.

DISCUSSION AND FINDINGS

The Board has carefully reviewed the record in this proceeding, including the arguments raised by the Advocate. The Board recognizes that the Advocate has raised significant issues with respect to the proposed Stipulation and Addenda. The gas contracts transfer would mean that the Board would not have the ability to delve into the gas procurement practices of Newco. Nor will it have the ability to alter the pricing agreements between PSE&G and Newco or any other contractual terms of the PSE&G/Newco agreement. However this is no different than the current situation under which PSE&G provides BGSS service. PSE&G enters into wholesale arrangements for gas supply and enters into pipeline obligations that are under FERC control. Currently, the Board does not have the authority to look behind the wholesale gas agreements or to alter FERC mandated pricing and operational terms and conditions. What the Board has now and would have in the future is the ability to hold PSE&G responsible for BGSS service and to regulate the terms and conditions of that service. N.J.S.A. 48:3-58(r). The Board will determine appropriate terms and conditions for BGSS service consistent with EDECA and PSE&G will be held responsible for meeting those terms and conditions. Currently, PSE&G enters into contractual obligations for capacity, commodity and storage, which are reviewed through Levelized Gas Adjustment Clause proceedings for prudence and possible disallowance. Any obligations that are found to be impudent, or costs which are disallowed, become the responsibility of PSE&G. Similarly, it does not matter that the Board does not have jurisdiction over the parties with which PSE&G has contracted. The Board currently sets and in the future will continue to set the BGSS rates, terms and obligations.

The Advocate raises a concern over the value at which the assets are being transferred. PSE&G's supply, capacity and storage rights have fixed durations and contractual terms and conditions determined by FERC. PSE&G has obtained these rights to serve its firm customer load. To suggest that there is a flourishing market for long-term capacity and storage by other than those with an obligation to serve customers overlooks the reality of the current marketplace. The Advocate cites PSE&G witness Wohlfarth's testimony that during the winter of 2000/01 gas delivered to New Jersey peaked at $25 per dekatherm, which was above FERC tariff rates, to indicate that, as a bundled transaction, the total value is greater than the sum of the parts. Advocate Supplemental Brief at 7-8. This may be true on a short-term basis, for a limited amount of capacity. As the Advocate points out, its example is for a $25 transaction for the 2000/01 winter. The Advocate does not provide similar evidence for summer periods or for any other period of time. Also, as indicated in this example, commodity prices at that time were around $10 per dekatherm. During the current winter, commodity prices are below $3 per dekatherm. It is not clear that bundled transactions would be similarly priced or whether a lower commodity price suggests a lower demand for commodity and capacity. The Advocate's argument in this regard is unpersuasive and unsupported. Further, the Advocate's argument is based on transactions for incremental amounts of supply and capacity. It is not clear that if the entire PSE&G supply/capacity portfolio were mixed in with the amount cited by the Advocate that the $25 transaction would not move to or below FERC-tariffed rates, and that on a year-round basis the average transaction for this larger volume would not be well below FERC-tariffed rates. The year-round value of the PSE&G supply and capacity portfolio is only addressed in the record by PSE&G witness Makholm who concludes that the cost of the contracts in question are $170 million above their market value. The Board believes that there is sufficient evidence to conclude that the PSE&G proposal as amended through the Addenda is providing fair value to the ratepayers through a reallocation of supply risks, enhanced supplier services, which may spur the competitive gas market, and market-based pricing for C&I customers.

The Advocate also indicates that the Proposal imposes a $.16 per dekatherm rate increase on commercial and industrial ("C&I") customers which has not been properly noticed and which the Ratepayer Advocate has not had the opportunity to review. Id. at 6. On or about November 2, 2000 PSE&G published a Notice of Filing in Docket No. GM00080564 that indicates in part:

> Because the Company's gas prices would be market priced monthly pursuant to its MPGS rate schedule, the Company's proposal may result in either higher or lower natural gas prices than exist currently.
>
> [PSE&G-1.]

The Advocate has been a party to this proceeding from the outset and has engaged in discovery and cross-examination of witnesses. The Board emphatically rejects the Advocate's argument that the change in rates has not been properly noticed and that it has not had the opportunity to review the proposed C&I pricing mechanism.

The Advocate also alleges that the market-based pricing proposal for C&I customers results in prices which would be based on neither actual costs nor on the results of a bid. Advocate Supplemental Brief at 6. The Advocate claims that the market-based pricing proposal is based on PSE&G's MPGS rate schedule and was originally designed as an unfavorable rate so that customers returning to BGSS would not create increased costs for existing BGSS customers. Advocate Initial Brief at 16. The Advocate's argument that the market-based pricing proposal is not based on actual costs is incorrect. As the Advocate notes in its Initial Brief, there is a formula for setting the floor and ceiling for this service based on the cost of interstate transportation and storage and short-term commodity indices or the highest cost of gas during the month. Id.at 16-17. Therefore, the proposal prices C&I BGSS customers based on actual procurement costs.

Contrary to the Advocate's assertions, MPGS was never designed as an unfavorable rate, but rather, as the Advocate notes, it was designed to recover the incremental cost of providing supply service to returning customers and to avoid creating additional supply costs for existing customers. Id.at 16. This, by definition, is cost-based service. The Board notes that currently the incremental cost of providing supply service could be higher or lower than the PSE&G tariff supply rate. MPGS was created with a floor price to satisfy a supplier concern that PSE&G tariff rates could be set to undercut suppliers in order to keep customers on sales service. At the same time, there was a concern about the MPGS price having no upper limit. An upper limit was established using the $.181/therm margin that has been in the Emergency Sales Service since C&I rates were first unbundled in 1994. MPGS was intended to put the Company's sales service to C&I customers on the exact same footing as that of competitive suppliers. This element of the Settlement Proposal, namely, pricing customers in a comparable way as competitive suppliers, is the key to competition in the C&I customer classes. Under the Settlement Proposal, Newco and suppliers are both at risk for the recovery of the fixed cost obligations under the pipeline contracts held to service their customers. This is true for Newco since there will no longer be a straight cost pass through via an LGAC-type mechanism for C&I customer classes. Therefore, both Newco and the competitive suppliers are at risk for weather and loss of load from customers leaving, in addition to incurring the added cost of the financial products needed to try to protect against these risks. There is no floor or ceiling on the price the third party supplier can charge. Competitive suppliers would not place themselves at risk for these significant costs without having the flexibility to price at competitive prices. In other words, competitive suppliers would not participate in the retail marketplace if the Board tried to regulate their prices, and in a competitive environment, it is appropriate that PSE&G be accorded similar flexibility for MPGS.

We further note that the MPGS price is very transparent. It is filed with the Board every month for all to see. In this manner, competitive suppliers have a known benchmark against which to compete. The possibility that PSE&G could charge any price it wants up to the ceiling would place it, and therefore Newco, at risk for total C&I migration to competitive suppliers. The Board FINDS that the MPGS pricing mechanism for C&I customers was duly noticed, is cost based, and is appropriate to encourage gas competition in these rate classes.

Concerning the C&I pricing proposal, the Advocate criticizes the removal of the $.05/therm credit for C&I off-system sales. Advocate Supplemental Brief at 6. Margins from off-system sales are returned to firm customers because, as firm customers, they are responsible, through the LGAC, for all reasonable and prudent costs incurred to provide the commodity to the customer. This would include FERC-tariffed pipeline capacity charges even when the capacity is not being 100% utilized. Therefore, to the extent the utility could re-sell unused pipeline capacity and/or package it with a commodity sale whereby the sale was above the cost of the commodity, the utility and thereby the ratepayers would be better served than having capacity sitting idle. This is only true where the customer is paying, such as through the LGAC, the full cost of reserving capacity and commodity to meet any variations in customer service requirements. When the customer is only paying for the pipeline capacity and commodity on an “as needed” basis, and some third-party is responsible for fluctuations in demand, then it is the third-party that is at risk for unused capacity and commodity and it is the third-party that should receive the benefits from such sales. In the current proposal, MPGS pricing will put Newco, not PSE&G customers, at risk for the capacity and commodity to provide service to C&I customers and therefore, it is appropriate that the margin sharing formula developed under an LGAC-based process be discontinued for these customer classes. Margin sharing would continue for residential customers, since they would still be subject to LGAC-type pricing.

The Advocate further claims that there is the potential for undue preference inherent in the PSE&G proposal, first in transferring resources to Newco without competitive bid and second in permitting Newco to potentially provide undue preference to its generation affiliate. Id. at 9. The Board has previously discussed the value of the asset transfer and found that the terms and conditions of the transfer of assets is fair to ratepayers. The proposal to transfer these assets is conceptually similar to the transfer of generation assets, which was approved in conjunction with PSE&G’s rate unbundling, stranded cost and restructuring settlement, by Board Order dated August 24, 1999 (Docket Nos. EO97070461, EO97070462 and EO97070463). As with the transfer of the generation assets, the Board needs to review the transfer of natural gas assets in the context of the entire Stipulation before it. The Board is not considering the transfer of PSE&G’s natural gas assets in isolation. The proposal before the Board provides additional features such as capacity and storage services for licensed gas marketers and new tariff provisions for certain ratepayer classes which are desirable to this Board which would not likely be included in a proposal that was strictly a divestiture. As for the potential for undue preference to the PSE&G generation affiliate, the First Addendum provides that during the term of the Requirements Contract, after Newco has satisfied its PSE&G BGSS obligations and its obligations to release capacity to licensed gas suppliers, Newco will make any excess capacity available to New Jersey unaffiliated generators under comparable terms and conditions as it does to its affiliated generation. PS-7 at 2. This provision obviates the Advocate’s concerns in this area.

The Advocate raises a concern about potential market power in terms of both the natural gas and electric markets in New Jersey. Advocate Initial Brief at 37-48. The Advocate maintains that a California type situation could occur as the result of Newco controlling significant gas resources in New Jersey. As indicated by PSE&G, the relatively small percentage of gas fired generation in the PJM region argues against the ability of any gas supplier to affect PJM electric markets. Given that Newco would be only one gas supplier in the PJM region and for that matter in New Jersey, the argument for Newco to exercise electric market power is weak. PSE&G Reply Brief at 11. As for the ability for Newco to unduly influence the natural gas market, in making such an argument one would have to assume, as the Advocate argues, that the significant pipeline and storage assets which would belong to Newco could be withheld from those requiring the use of those assets in order for market power to exist. This is simply not the case. Newco is committed to provide the BGSS requirements of PSE&G and to make capacity available to those licensed suppliers desiring to use it to serve PSE&G customers as well as to New Jersey generators, when excess capacity exists. Therefore the capacity and storage assets left for Newco to use at its discretion to unduly influence prices in the PSE&G service territory, and certainly in New Jersey as a whole, is a small portion of the overall portfolio and considerably less than the Advocate would suggest. Should the Board have reason to believe that undue market power was developing, in either the electric or natural gas arenas, the Board has the authority to investigate such allegations and take such actions, including filing a complaint with FERC, or other regulatory authority, as may be warranted to remedy the situation.

Finally, the Advocate indicates that the Settlement Proposal would subject ratepayers to high and unstable rates, uncertain reliability, and diminished consumer protections, while recognizing the incentive in the Proposal to promote competition and the transfer of pipeline risk from consumers to Newco. Advocate Initial Brief at 60-61. The Settlement Proposal does provide the two benefits to ratepayers identified by the Advocate. The Advocate has previously been vocal in its support of the need for additional incentives to increase competition in the energy markets. The Board has heard numerous comments since the implementation of EDECA for natural gas in 2000 that market-based pricing is the primary element necessary in order for gas competition to develop. This proposal will move all non-residential customers to market-based pricing and provide the opportunity no sooner than 2004, after experience with the non-residential classes, to investigate and possibly consider similar pricing structures for residential customers. As for the Advocate's concerns about unstable rates, reliability and consumer protections, we have previously indicated our belief and intention that BGSS is a fully regulated service subject to Board oversight in each of the areas identified by the Advocate.

The Board has carefully reviewed the record in this matter, the Stipulation of Settlement and the First and Second Addenda thereto, the revised Requirements Contract, as well as the Initial Briefs, Reply Briefs and Supplemental Briefs of the parties. Based upon the foregoing discussion, the Board FINDS that the Company's proposal to transfer its interstate capacity, storage and supply contracts to Newco and to enter into the revised Requirements Contract with Newco is reasonable.

The Board HEREBY APPROVES the Stipulation of Settlement as amended by the First and Second Addenda, and attached hereto and DENIES the Ratepayer Advocate's motion to dismiss the petition. The Board emphasizes that it will continue to exercise its jurisdiction to regulate BGSS rates, terms and conditions as required by EDECA. The Board DIRECTS PSE&G to file revised tariffs consistent with this Order within ten business days of the date of this Order and to inform the Board within five business days of the completion of the asset transfer with a full and detailed accounting of the specific assets transferred to Newco. The Board also notes that since the final documents were filed in this proceeding, a PSE&G base rate case was concluded (Docket No. GR01050328) which resulted in modifications to certain rate class designations. As part of the compliance filing, the Board DIRECTS PSE&G to file a list showing how the prior rate classes referenced in the current Stipulation and Addenda relate to current rate class designations and to file, where necessary, a revised Stipulation of Settlement, the First and Second Addenda thereto, and the revised Requirements Contract, using the current customer rate class designations.

DATED: April 17, 2002

BOARD OF PUBLIC UTILITIES
BY:

(SIGNED)

CONNIE O. HUGHES
COMMISIONER

(SIGNED)

FREDERICK F. BUTLER
COMMISSIONER

(SIGNED)

CAROL J. MURPHY
COMMISSIONER

ATTEST: (SIGNED)
KRISTI IZZO
SECRETARY